In the Supreme Court of the United States

OCTOBER TERM, 1966

No. 1146

THE COASTAL CLUB, INC., PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

MEMORANDUM FOR THE RESPONDENT IN OPPOSITION

Petitioner is a corporation organized in 1928 primarily as a duck hunting club under the non-trading corporation laws of the State of Louisiana. Upon its organization, petitioner acquired approximately 6,000 acres of marshland with a clubhouse thereon. Petitioner has realized substantial and recurring income from oil and gas leases which it has executed on this land. The question presented is whether because of this substantial income and the surrounding activities petitioner has lost its exemption from income tax under § 501(c)(7) of the 1954 Code which exempts the income of:

> Clubs organized and operated exclusively for pleasure, recreation, and other nonprofitable

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> purposes, no part of the net earnings of which inures to the benefit of any private shareholder.

The Tax Court upheld the Commissioner's determination that petitioner was not exempt for the taxable years in issue (1957–1960). The court of appeals affirmed *per curiam*. (R. 574, 576, 654; Pet. App. A 1a–2a.)

The decision below is correct and there is no conflict of decisions or other basis for further review by this Court.

1. Petitioner fails to qualify under § 501(c)(7) because it had a profit-seeking operational purpose and because some of those profits clearly inured to the benefit of its member-shareholders.

In its *per curiam* affirmance of the decision of the Tax Court, the court of appeals cited and followed its own earlier opinion in *United States* v. *Fort Worth Club of Fort Worth, Texas*, 345 F. 2d 52 (C.A. 5), modified and reaffirmed, 348 F. 2d 891. In *Fort Worth Club*, the court emphasized that the legislative history of § 501(c)(7)'s social club exemption indicates that the outside profits of such a club are not immune from taxation merely because they are used for club purposes. Such club-related use does not make social clubs exempt from taxation, since Congress did not grant them exemption because it desired to foster their activities. Rather, it was felt that the taxes collected would be negligible. See also H. Rep. No. 922, 64th Cong., 1st Sess., p. 4 (1939–1 Cum. Bull. (Part 2) 22, 24). Accordingly, the court held that, in order for a social club to qualify for tax-exempt status, its outside profits must be strictly inci-

dental to club activities and either negligible or non-recurring. In that case and in the case at bar, the profit-seeking activities of the taxpayer-club were unrelated to its exempt purposes and the profits therefrom were so substantial and recurring that the club was not "supported solely by membership fees, dues and assessments" as required by Treasury Regulation § 1.501(c)(7)–1, the regulation which was upheld by the Fifth Circuit in *Fort Worth Club*.

During the years in issue (1957–1960), petitioner received over $489,000 in outside profits from oil and gas leases, while its income from club-related sources was $35,000. Petitioner has received income from oil and gas leases in every year from 1944 through 1963, the average annual amount of which exceeds $44,000 (R. 607).

In addition, it cannot be doubted that the oil and gas profits "inured" to the benefit of petitioner's member-shareholders. Petitioner's expenditures for club purposes were as much as five times the amount collected in dues and charges from its members during the years at issue. It is well settled that the earnings of a club may inure to the benefit of its member-shareholders although the earnings themselves are not distributed. See *West Side Tennis Club* v. *Commissioner*, 111 F. 2d 6, 8 (C.A. 2), certiorari denied, 311 U.S. 674; *Jockey Club* v. *Helvering*, 76 F. 2d 597, 598 (C.A. 2). Moreover, it is relevant that petitioner's member-shareholders have attempted to devise some means for distributing its substantial surplus ($735,233.67 as of March 31, 1963) to themselves (R. 610).

As both courts below correctly held, exemption from taxation does not depend upon whether petitioner's outside income was derived from engaging in business. The existence of a profit-making purpose (which may be inferred from what the organization actually does) is the proper test. Assuredly, a club which carries on an active trade or business is not exempt. This does not imply, however, that a club with substantial and recurring outside profits *not* from a business is exempt. Accordingly, the Commissioner has long ruled that the receipt of outside profits *not* from a business may disqualify a club from exemption. G.C.M. 13067, XIII–2 Cum. Bull. 148 (1934); I.T. 2622, XI–1 Cum. Bull. 65 (1932). And the courts have so held. *Jockey Club* v. *Helvering, supra; Spokane Motorcycle Club* v. *United States,* 222 F. Supp. 151 (E.D. Wash.); *Spokane Commercial Travelers* v. *Squire,* 126 F. Supp. 424 (W.D. Wash.). Furthermore, the theory that an exempt club can maintain its exemption despite the receipt of passive income in an unlimited amount was rejected by the Fifth Circuit in *United States* v. *Fort Worth Club, supra.*

2. Petitioner contends that the decision below and the *Forth Worth* decision conflict with two earlier decisions of the Fifth Circuit in *Koon Kreek Klub* v. *Thomas,* 108 F. 2d 616, and *Scofield* v. *Corpus Christi Golf & Country Club,* 127 F. 2d 452. But such an intra-circuit conflict does not require resolution by this Court; if there is such a conflict, it is appropriately to be resolved by *en banc* consideration of the court of appeals. Taxpayer sought such an *en banc* considera-

tion in the *Fort Worth* case on precisely that basis (348 F. 2d 891); in denying such rehearing, the Fifth Circuit apparently treated its later decision as modifying the earlier ones, to the extent there might have been some inconsistency. Indeed, in *Fort Worth* the Fifth Circuit indicated that other authorities were "[c]loser in point, and more consistent with the legislative history of the statute" (345 F. 2d, p. 57). See also *Jockey Club* v. *Helvering, supra.*

3. Similarly, petitioner incorrectly argues that Congressional consideration of H.R. 15942, 89th Cong., 2d Sess., is relevant to the instant case (Pet. 10–12). That bill, as its title discloses, relates to the imposition of "a tax on unrelated debt-financed income of tax exempt organizations." It is designed to expand the "unrelated business income" provisions (§§ 511–512) of the 1954 Code in order to deal with the problem considered by this Court in *Commissioner* v. *Brown,* 380 U.S. 563. As observed by the court of appeals in its *Fort Worth Club* opinion (345 F. 2d, p. 56), the "unrelated business income" provisions never have applied to clubs, and the "only reasonable inference" to be drawn from their deliberate exclusion is that Congress assumed that clubs receiving such income would be barred from exempt status by the terms of § 501(c)(7). Viewed in that light, there is nothing in the terms or background of H.R. 15942 to indicate legislative dissatisfaction with the manner in which the courts have construed § 501(c)(7) in determining the tax status of clubs.

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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